Dec 11 2008

REPORT

OF

MR. G. F. SHEPLEY, K.C.

RE

GRAND TRUNK PACIFIC SECURITIES

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The Honourable W. S. FIELDING,
Minister of Finance,
Ottawa.

DEAR MR. FIELDING:—The various instruments which have been prepared for the purpose of working out the provisions of the two agreements between the Government and the Grand Trunk Pacific Railway Company and the validating Acts, so far as the same provide for Government aid in respect of the Western Division, having now been settled between counsel and being now ready for submission to the Governor General in Council, I beg to present a report upon them.

My instructions were originally given by the Minister of Justice, who desired me to be associated with you as representing him in the matter of the preparation and settlement of the instruments upon which I am now to report, and during negotiations between the counsel concerned I have had the advantage of being able to refer to and consult with you upon the different questions from time to time as they arose.

The counsel engaged in the negotiations from time to time have besides myself been counsel representing the Grand Trunk Pacific Railway Company, the Grand Trunk Railway Company, the purchasers of a portion of the first mortgage bond issue and the purchasers of the whole of the second mortgage bond issue.

The Instruments to be reported upon are as follows:—

I

THE INSTRUMENT CREATING THE FIRST MORTGAGE CHARGE, SECURING THE BONDS WHICH THE GOVERNMENT IS TO GUARANTEE.

The general scheme of the Instrument is as follows: The relevant provisions of the two agreements between the Government and the Pacific Company and of the Acts validating them, are set out by way of recital. A further recital settles the forms of the bonds, the interest coupons and the guarantee to be signed by the Government. Certain resolutions of the Pacific Company authorizing the issue of the bonds and the execution of the mortgage, are settled in form by another recital. The operative provisions of the mortgage are then set out in a series of eleven articles.

The First Article gives extended definitions to certain compendious expressions made use of in the mortgage for purposes of convenience.

The Second Article conveys the property which is to form the security to the trustee, the Royal Trust Company, by an extended and exhaustive description.

The Third Article deals with the issue and registration of the bonds to be secured, and with the appropriation of their proceeds.

The Fourth Article contains the provisions relating to the guarantee of the Government.

The Fifth Article assembles the covenants of the mortgaging Company, including the covenants for the payment of the principal and interest of the bonds, limiting however the convenant for the payment of interest so as to preserve the provisions of the agreements in that respect.

The Sixth Article redemises the property to the Company until default, and revests it in the Company when the security has served its purpose and the Company has paid off its bonds.

The Seventh Article makes carefully protected provision for releasing portions of the property mortgaged when they become superfluous, for the application of the proceeds realizable therefor to the purchase of other property, and for bringing such substituted property within the mortgage charge.

The Eighth Article contains an exhaustive series of remedies exercisable by the holders of the bonds or by the trustee in case of default by the Company, either in payment of the bonds and interest or in performance of its other covenants. These remedies include the taking possession and management of the property, as well as the sale or leasing of the property, but are not exercisable without the consent of the Government, so long as the Government continues to pay any bond interest in respect of which the Company makes default.

The Ninth Article makes proper provision for protecting and indemnifying the trustee, for the resignation or removal of the trustee and for the appointment of a new trustee.

The Tenth Article embodies a scheme for holding meetings of bondholders, and for the procedure in respect of such meetings. It defines the business which may be transacted, and fixes the voting strength of bondholders including the Government where the Government has paid out money upon its guarantee.

The Eleventh Article contains the trustee's acceptance of the trust, and provides for the execution of the mortgage and for its deposit with the Secretary of State as the sole method of registration necessary.

The mortgage is in my opinion entirely consistent with and nowhere either exceeds or fails to carry out the provisions of the agreements and Acts upon which it professes to be based, with the following exceptions :

(*a.*) The guarantee of interim bonds during the period of construction to be compulsorily convertible into the guaranteed permanent bonds on the completion of the work of construction, which was the scheme for interim aid contemplated by the agreement of 1903. During the negotiations it was found impracticable to devise a workable scheme on the precise lines of the agreement, and there were found to be formidable market objections to bonds issued on the terms contemplated. The method adopted in the mortgage submitted is to provide for the immediate issue of permanent bonds, adding to the 50 year period of currency of such permanent bonds, which period was under the agreement to begin on the completion of the division, the 7 years limited by the agreement of 1904 for such completion, making the bonds at once 57 year bonds. The mortgage provides that the proceeds of these bonds as they are marketed from time to time are to be placed at the credit of the Minister of Finance and Receiver General in approved banks, and paid out from time to time with certain safeguards, as they are earned by construction work. During the period of construction the interest paid upon these bonds is added to and forms part of the cost of construction. During such period of construction, therefore, being presumably the seven years limited by the agreement of 1904, the permanent bonds now provided for perform the identical functions which the interim bonds would have performed under the original scheme. When the work of construction is completed, these bonds inherently ripen into the fifty year permanent bonds contemplated by the agreement of 1903, and from that date all the provisions of the two agreements relating to permanent bonds begin to operate upon them. The difference is in my opinion merely formal, and does not in any degree alter the substance of the rights and obligations of the parties.

(*b.*) There has been some amplification of detail in the definition of cost of construction given by the 15th paragraph of the agreement of 1903. This does not I think in substance add anything more to such cost than would have been added under the general words found in that paragraph, 'and generally costs and expenses occasioned by the construction of the said division, whether of the same kind as or differing in kind from the classes of expenditure specially mentioned.' I should further point out under this head that cost of material and supplies acquired for purposes of construction are permitted to enter into the estimate of cost of construction before they are actually delivered upon the work, provided they have been delivered in Canada, and upon such delivery in Canada they become at once a parcel of the property covered by the mort-

gage. This provision in my opinion adequately protects the Government, while it substantially facilitates the financing of the work by the Company.

(c.) The mortgage assumes to fix a limit to the bond issue. Some discussion has taken place between counsel in this connection. It has been suggested that the face of the bond issue should be definitely measured by 75 per cent of the cost of construction, not exceeding $13,000 per mile in respect of the Prairie Section, though the agreement of 1903 in paragraph 32 provides specifically for the issue of bonds to be secured by the mortgage for the capitalized three years' interest, payment of which the Company is permitted to defer, and though the agreement of 1904 by paragraph 5 provides for an implementing by the Government of its guarantee of the bonds of the Company to be issued for the cost of construction of the Western Division. The method finally arrived at and the result of which is to be embodied in the mortgage, is to make an estimate of the cost of construction, an estimate also of the possible capitalization of interest for three years, and a further estimate of the amount involved in the implementing scheme and to allow a fair safety margin in addition to these estimates, so that the Company may not find itself left with its bond issuing power exhausted, before full provision has been made for all the expenditure which the agreements contemplate.

The Company's officials have furnished a memorandum, and this memorandum has been checked by the Deputy Minister of Railways and Canals, and the limit finally agreed upon (£14,000,000 stg.) has been fixed with reference to the principles stated above.

The memorandum furnished by the Company's officials required correction in some details, and after correction the figures based upon that memorandum appear to be as follows:

Cost (including terminals) of both sections	$51,560,000
15 per cent for contingencies in respect of the Mountain Division	5,175,000
3 years' interest capitalized	3,854,250
Bonds to implement upon a basis of 92½	4,255,125
Total	$64,844,375
	or £13,340,000

The estimate of the Deputy Minister of Railways and Canals is as follows:—

Cost (including terminals) of both sections (This includes an allowance for contingencies).	$55,000,000
3 years' interest capitalized	3,700,000
Bonds to implement	4,125,000
Total	$62,825,000
	or £13,000,000

The mortgage contains a careful provision for applying any surplus proceeds of bonds on hand after completion to the buying in and cancellation of outstanding bonds, so that there may not in the result be any over-issue, having regard to the powers of the Company.

I should perhaps point out that while the provision made in the mortgage does not distinguish between bonds to be issued for the three years' interest capitalized and bonds for construction work, the scheme of the mortgage enables the bonds for capitalized interest to be treated in the method prescribed by the agreements. If the total estimate for the bond issue is adequate there will be on hand, when the work of construction is completed, unissued bonds to an amount equal to the possible capitalization of this interest. When three years from the date of completion have gone by, these bonds will be on hand, to be handed over to the Government should the Company elect to capitalize this interest, and they will have been from the beginning within the security of the mortgage charge. So long as they remain in the possession of the Govern-

ment no guarantee need be endorsed upon them, but should the Government wish to convert them into money I have no doubt the Government will be able to deal with them, by guaranteeing them or otherwise, without affecting their validity as constituting a charge under the mortgage upon the mortgaged premises. These bonds were originally provided for as forty year bonds, dating of course from the period of seven years plus three years (equals ten years) from the date of completion of construction, the seven years being the period during which the Government pays the interest without recourse and the three years being the period during which the Company is permitted to defer payment. To this period of ten years should be added the arbitrary seven years during which the work of construction is expected to be proceeding, making in all a period of seventeen years. If this period of seventeen years is deducted from the 57 years during which the bonds have to run, these bonds for capitalized interest are left practically 40 year bonds, as the original agreement contemplated.

Another matter which it is proper to mention is that counsel for the proposing bondholders under this and the second mortgage have raised a question as to what the result may be if the bonds issued under both mortgages together exceed the limitation prescribed by sec. 13 of the Company's Act of incorporation, 3 Edw. VII, cap. 122.

In my view this limitation, if it should be exceeded in the working out of the two agreements by means of the first and second mortgages, would be so exceeded by reason of the Company exercising 'the powers necessary to carry into effect' the two agreements.

The Act 4 Edw. VII, cap. 80, which validates the two agreements, expressly confers by sec. 4 all such powers. I do not therefore see any force in the suggestion.

Wherever it has seemed expedient or possible, having regard to the fundamental differences, the form of the security approved in the case of the aid given to the Canadian Northern Railway Company has been adopted. The most striking departure from this form is in respect of the method of authenticating the Government guarantee, though this it seems to me is rather a difference in form than in substance. In the case of the Canadian Northern mortgage the method of guarantee was the execution and delivery to the trustee of a general instrument of guarantee, a copy of which was printed upon each individual bond. The counsel acting for the English purchasers made a point of having what is really an original guarantee endorsed upon each individual bond, the method of signature being an engraved signature of the Minister of Finance having the force of an original signature. At the same time, letters to the Messrs. Rothschild, who are floating the partial issue of these bonds, and to the Company are provided for, stating that the engraved signature upon each bond is duly authorized.

There is nothing else I think in the first mortgage under consideration requiring special mention. There is I think no other question that can be raised suggesting any excess in this instrument of the provisions of the agreements of 1903 and 1904 and of the validating Acts of Parliament.

II

SECOND MORTGAGE GIVEN TO SECURE BONDS GUARANTEED BY THE GRAND TRUNK RAILWAY COMPANY.

The Agreements upon this subject required the balance of the funds necessary for the payment of cost of construction to be provided by bonds guaranteed by the Grand Trunk Railway Company and secured by second mortgage, and the assent or approval of the Government to the form of this mortgage is made necessary. The Instrument prepared for that purpose is I think entirely unobjectionable in form, and provision has been made in it of a most ample kind, subjecting the security effected by it to the security effected by the first mortgage in which the Government is directly interested. I see no reason, therefore, why the approval of the Government should not be given to this second mortgage.

III

BONDS, COUPONS AND GOVERNMENT GUARANTEE.

The forms of these instruments are settled by the terms of the first mortgage, and are in my opinion satisfactory, and I see no reason to withhold the approval of the Government from the forms so settled.

IV

THE INSTRUMENT REQUIRED BY THE ACT 4 EDWARD VII, CAP. 24, SEC. 8.

This instrument I have put into the form of a simple covenant practically in the words of the Statute. A copy of this instrument accompanies this Report. Upon execution of the instrument, which is in the hands of the counsel for the Grand Trunk Railway Company for that purpose, and its delivery to the Government, the provisions of section 8 of the Act 4 Edward VII, cap. 24, will have been fully complied with.

V

THE FORM OF LETTER TO BE WRITTEN AUTHENTICATING THE ENGRAVED INDIVIDUAL GUARANTEE UPON THE FIRST MORTGAGE BONDS.

This form has been settled by counsel and is submitted herewith. I am of opinion that there is no objection to sending the letters to the Messrs. Rothschild and to the Company as soon as the Order in Council has been passed.

VI

BILL PROPOSED TO BE INTRODUCED TO VALIDATE THE DIFFERENT INSTRUMENTS EMBRACED IN THIS REPORT.

There are two matters in this Bill which require mention. The first is the proposal that the section of the Bill validating the first mortgage and the bonds issued and to be issued under it should be expressly declared to be binding upon the Crown. I do not see any objection to this. The other is the removal of the limitation made by sec. 13 of cap 122 of the Statutes of 1903, so that the bonds contemplated by the several mortgages may be validly issued notwithstanding that limitation. This provision seems to me to be quite proper, although probably not necessary.

OTTAWA, May 29, 1905.

GEO. F. SHEPLEY.